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The Voice of Small Business

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Testimony on House Bill 4342
A Proposal to Remove the Cost of Health Insurance from the Single Business Tax Base

Testimony before the House Tax Policy Committee
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My name is Charles Owens and I am the State Director for the National Federation of Independent Business, an organization providing legislative advocacy for almost 20,000 Michigan small businesses.

We are here today to support your efforts to improve Michigan's business climate by removing the cost of health insurance from the state's Single Business Tax (SBT). I have taken the liberty of providing copies of testimony before the Senate Finance Committee of two NFIB members from September of 2003. Although the testimony concerned the bills that were passed in that session that will remove fifty percent of the cost of health insurance from the base by 2007, the points made are as relevant today as they were at that time. Also with me here today is Ron Phillips, a member of NFIB and a small business owner. Mr. Phillips will give some specific examples of how the current practice of including the cost of health insurance in the SBT impacts his business.

SBT History and Changes: Since its' inception, the SBT has been a subject of controversy among policy makers and the business community. In its original form the tax was known as a VAT or "Value Added Tax". In theory this approach taxes a good or product as value is added to it during processing or manufacture. The tax is common in Europe and many socialist countries, but in the Unites States, Michigan is the only state with this type of tax. From an advocate's perspective, the tax solved the problem of the cyclical nature of the corporate profits tax and the resulting impact on state tax revenues. It has also been argued by proponents of the tax that the SBT has resulted in a more simple tax system because it eliminated numerous other business taxes. The business community, on the other hand, has enumerated a number of concerns about the SBT relating to its' impact on profitability, job creation, and economic development. Because the SBT is based primarily on payroll, and not profit, many businesses are required to pay an SBT liability even though they made no profit or were losing money. It is also pointed out that by taxing payroll; the tax serves as a disincentive to create jobs. Small businesses that did not pay the corporate income tax, and had a negligible liability under the other taxes eliminated by the SBT, suddenly found themselves liable for taxes under the new SBT. For many small businesses the complexity of the tax required the use of a professional tax preparer at a fee, the cost of which exceeded the SBT liability. Businesses with operations and sales in other states have struggled with the issue of apportioning the tax base and the Capital Acquisition Deduction or CAD (under the CAD a business can deduct the purchase of real and personal assets acquired during the year from the SBT base for that year) between other states. In 1999 the CAD was changed to an Investment Tax Credit (ITC) because of continued litigation over the CAD. From an economic development perspective, the tax has been cited as a reason why companies choose not to locate operations in Michigan. The unique nature of the tax, and the fact that only Michigan levies it, makes for a difficult comparison with the tax climate in competing states.

Many of the changes to the SBT over the years reflect the various attempts to address the aforementioned concerns. In past sessions of the legislature significant changes to the SBT include: Lowering the rate from 2.35% to 2.30%, raising the gross receipts threshold to $250,000, removing workers' compensation, FICA, and unemployment insurance taxes from the payroll base, changing the apportionment formula for multi-state businesses, and expanding the parameters that allow some businesses to pay an alternative profits tax instead of the SBT.

In 1999 the legislature and Governor Engler passed Public Act 115 that started the elimination of Michigan's Single Business Tax (SBT) over 23 years by reducing the rate by 0.1 percent each year, beginning in 1999. From 1999 until 2002, the SBT phase out stayed on schedule and the rate was reduced from 2.3 percent to the current rate of 1.9 percent. The Act included a provision, known as a "trigger" that would defer the next calendar year's reduction if the state's Budget Stabilization Fund (BSF), also known as the "rainy day fund," were to close a fiscal year at an amount below $250 million. The rate reductions would continue again, when the BSF balance returned to at least $250 million. At the end of the 2002 session, the legislature addressed budget shortfalls by halting the scheduled phase-out of the single business tax. This was done by drawing the BSF down below $250 million and activating the trigger. In addition to halting the phase out, the legislature also raised the filing threshold for the tax from the previous $250,000 in gross receipts to $350,000 and included a "sunset" provision that would repeal the entire Single Business Tax Act in 2010.

Because of the many changes to the original law, the tax is viewed by many as a compromise between a pure VAT and a corporate income or profits tax. The cumulative result of these changes over the years is a shift in attitudes and policy positions by various segments of the business community concerning the SBT. Many who were originally in favor of repealing the tax and replacing it with another form of taxation have modified their position. One of the barriers to repealing the SBT concerns the issue of replacement revenue. Some calculations have indicated that in order for a profits tax to replace current SBT revenue, the rate would have to be 16.8 per cent, or more than double the highest corporate income tax rate among midwestern states. Other alternatives, such as a gross receipts tax, lack consensus among the business community.

In her recent State of the State address, the governor has proposed a restructuring of the Single Business Tax. The merits of that proposal are still under scrutiny by many in the business community including NFIB. NFIB has not taken a position on the governor's proposal at this time.

NFIB POSITION: In surveying NFIB members we have found that support is strong for continuing the phase-out of the tax as planned in the 1999 legislation. Support is also expressed for continued modifications that address inequities such as the inclusion of other taxes and the cost of employee benefits in the tax base.

NFIB supports the efforts of the committee and the legislature and we urge the committee to support House Bill 4342.